NORTHEAST-MIDWEST CONGRESSIONAL COALITION

U.S. House of Representatives

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Negotiating a U.S.-Canadian Free Trade Agreement

A Review of Major Issues

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EXECUTIVE SUMMARY

May 21, 1987

The United States and Canada are in the final stages of drafting a bilateral free trade agreement. This report examines the major issues on the negotiating table and presents sector-specific concerns of both the U.S. Government and private industry with regard to existing trade arrangements with Canada. Sectors which the report addresses include automotives, agriculture, electronics, investment, services, steel, and energy. Also of critical concern are non-sectoral issues such as subsidies, government procurement policies, and customs procedures. The paper concludes with recommendations for specific changes sought under a bilateral pact; a system for monitoring those changes; and ways to effectively address trade disputes in the future.

The report also serves as briefing material for a breakfast meeting in which Ambassador Peter O. Murphy, chief U.S. negotiator with Canada, will discuss the progress of the bilateral trade negotiations with Members of Congress. The meeting is scheduled for June 10, 1987 at 8:30 a.m. in 1537 Longworth House Office Building. It will give Members an excellent opportunity to voice their concerns to the Administration regarding items that should be addressed in the trade pact.

The United States and Canada enjoy the largest trade relationship in the world, with two-way trade valued at over $169 billion. Although the U.S. and Canada possess a high degree of economic interdependence, both countries would benefit substantially from greater efficiency in the marketplace if trade barriers were reduced or removed. In negotiating a free trade agreement, the U.S. and Canada are seeking greater competitiveness in North American markets; a smoother bilateral trade relationship (particularly in resolving disputes); and cooperation in third country markets such as the European Community. Beyond these broad goals, the U.S. has the following specific interests:

- Demonstrate to the world trading community its commitment to free and fair trade, and to use bilateral negotiations as a model for addressing issues multilaterally;

- Pull Canadian provinces into a broad trade agreement, thereby subjecting their commercial policies and development programs to provisions of the agreement;

- Address the inequities in bilateral automotive trade; specifically, remove the duty remissions program and Canadian value added requirements and make changes in the U.S.-Canadian Automotive Agreement (Auto Pact), which is heavily skewed in Canada's favor. (This is a clear state objective more than an objective stressed by the federal government.)

And finally, there is a fundamental difference between the importance that Canada and the U.S. have placed on negotiating a trade pact. A bilateral agreement is a top priority for Canada, receiving wide-spread interest from provincial governments and private industry, and the subject of heated debate nationally. In contrast, the U.S. Administration, Congress, and private industry have shown varying degrees of interest, which the Canadians have interpreted as indifference. This disparity could jeopardize negotiations. It is crucial that the Congress participate in the negotiations over the next few months before the final agreement is presented to Congress in September, at which time it will be up for approval or disapproval with no amendments allowed.

I. Introduction

Trade representatives from the U.S. and Canadian governments are in the midst of negotiating a bilateral pact that will fundamentally change the trade patterns across a broad range of sectors. Canada is the United States' most important trading partner; last year, Canada imported $78 billion in American goods, while exporting ~~$95~~ 77 billion to the U.S. (Note: all dollar figures in this report refer to U.S. dollars.) This ~~$169~~ 155 billion in two-way trade makes the U.S. and Canada the world's largest bilateral trading partners. Moreover, trade with Canada has enormous importance for the Northeast-Midwest Region, which accounts for 68 percent of total US.-Canadian trade.

The bilateral pact has been placed on a fast track legislative agenda. The U.S. Administration should have a draft of the agreement by early June to present to Congress for comments. A final draft will be ready in September, at which time the Congress will have 90 days to approve or disapprove the agreement without making any amendments. This restriction means that Congress has only the next few months to influence the negotiating agenda and affect bilateral trade policy. In view of this tight time frame, this paper discusses the major issues under consideration and highlights the problem areas where members of Congress may want to voice their concerns to the Administration. It concludes with recommendations for resolving specific policy differences and for laying the groundwork for monitoring bilateral trade in the future.

This paper concentrates on the effect the bilateral pact will have upon both U.S. and Canadian industry. The underlying factors driving the respective economies and the consumer effects of a bilateral pact, while important, are beyond the scope of this paper. Additionally, although exchange rates strongly influence trade performance and the current account balance, currency issues fall under the jurisdiction of the IMF and such special arrangements as the Group of Five or the Group of Seven Industrialized nations. Acid rain, likewise, is a separate issue from the trade negotiations and is therefore not addressed here.

II. Background on Bilateral Trade

The United States and Canada boast the world's largest bilateral trading relationship, with two-way trade roughly twice the trade volume between the United States and Japan. U.S. trade with Canada is considered relatively open. Over 80 percent of Canada's exports enter the United States duty-free, compared to 70 percent of U.S. goods shipped to Canada. Despite this general openness, a broad trade pact is needed to address existing tariffs, non-tariff barriers, and sectors not covered by an agreement where bilateral trade has grown significantly. Both countries are aware that the trade talks will be watched worldwide as a possible model for multilateral negotiations. If successful, they will likely set the precedent for how other trading nations will address issues not covered by the GATT such as agriculture, investment, and services.

In discussing the costs and benefits of a bilateral free trade agreement, it is important to recognize the extent to which Canadian provinces maintain control over trade. Of particular concern is the enormous autonomy the provinces enjoy over their commercial policies and development programs. The U.S. is concerned that any agreement reached between the U.S. and Canadian federal governments be legally binding against Canadian provinces.

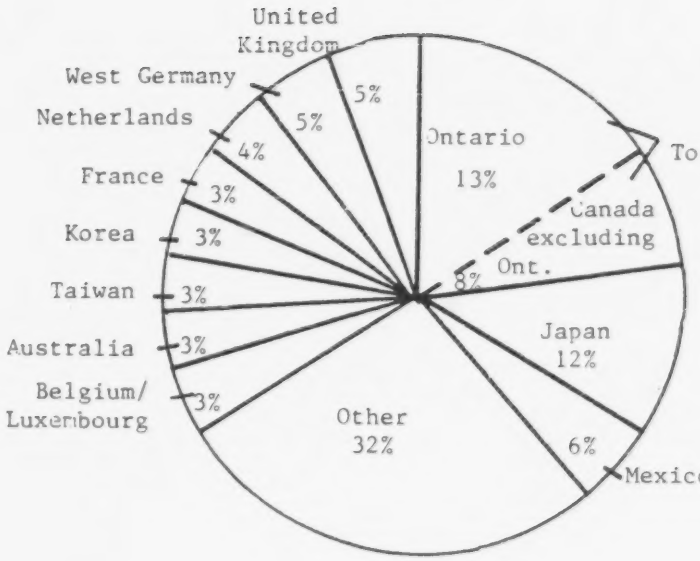
Major economic differences exist between the United States and Canada beyond the size of their markets and economic bases. Canada is generally more trade dependent than the United States. Almost one-third of Canada's total production of goods and services is exported (compared to 10 percent of total U.S. production), and exports and imports together account for roughly 40 percent of Canada's Gross National Product (GNP). Close to 80 percent of Canada's exports were shipped to the United States in 1985, which accounted for 18 percent of total U.S. merchandise imports, as shown in Graph 1. In contrast, about 22 percent of U.S. exports were shipped to Canada during that year. Canada is equally dependent on the United States for foreign investment. According to one Canadian journal, an estimated 60 to 70 percent of Canadian manufacturing is owned by U.S. interests. These data indicate that Canada has more to gain or lose in negotiating a new bilateral trade pact.

Along with Canada's strong commercial dependence on its southern neighbor, the U.S. relies heavily on trade and investment with Canada. It has been estimated that two million American jobs depend on U.S. exports to Canada. Fifty percent of these jobs are located in twelve states, nine of which are within the Northeast-Midwest Region. According to a recent study by the Institute for International Economics (IIE), a bilateral pact with Canada would increase U.S. exports by about 7 percent.

Since 1970, the U.S. has consistently run a merchandise trade deficit with Canada, growing to $23 billion in 1985, according to official U.S. statistics. The Congressional Research Service (CRS), however, estimated the U.S. bilateral merchandise deficit to be about $17 billion in 1985. Canadian sources offer even more varying figures for the merchandise trade balance, with the Canadian Federal Government reporting a $15 billion U.S. deficit. Trade figures released by Statistics Canada fell more in line with U.S. figures, with an estimated merchandise trade deficit of $21 billion in 1985. These trade figures represent only the shipment of goods. The United States runs an approximate $14 billion surplus in services with Canada, which when taken into account reduces the overall trade deficit considerably. Graph 2 shows the U.S. merchandise trade and current account balances with Canada since 1960 based on figures released by CRS.

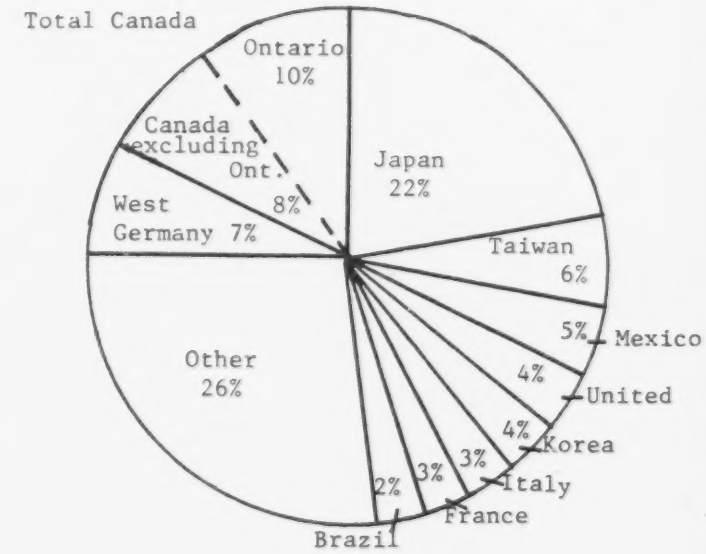
The composition of goods shipped between the two countries differs significantly. The United States primarily exports to Canada manufactured and semi-manufactured goods such as automobiles, telecommunications, computers, and machinery. In contrast, the leading Canadian exports are transportation equipment (most of which is covered under the U.S.-Canadian Automotive Pact), and natural resource based products such as forestry goods, fuels, and minerals. Tables 1 and 2 provide a breakdown of Canadian trade with the U.S. by province. Exports of natural resource goods are less visible to U.S. policy makers than finished products, which has helped Canada skirt the strong market opening pressures imposed by the U.S. on Japan and other trading partners. A shift is occurring in Canada away from exports of raw materials toward more manufactured products. With this transition comes growing vulnerability to U.S. trade protection.

Graph 1
U.S. Merchandise Trade - 1986



U.S. Merchandise Exports - 1986

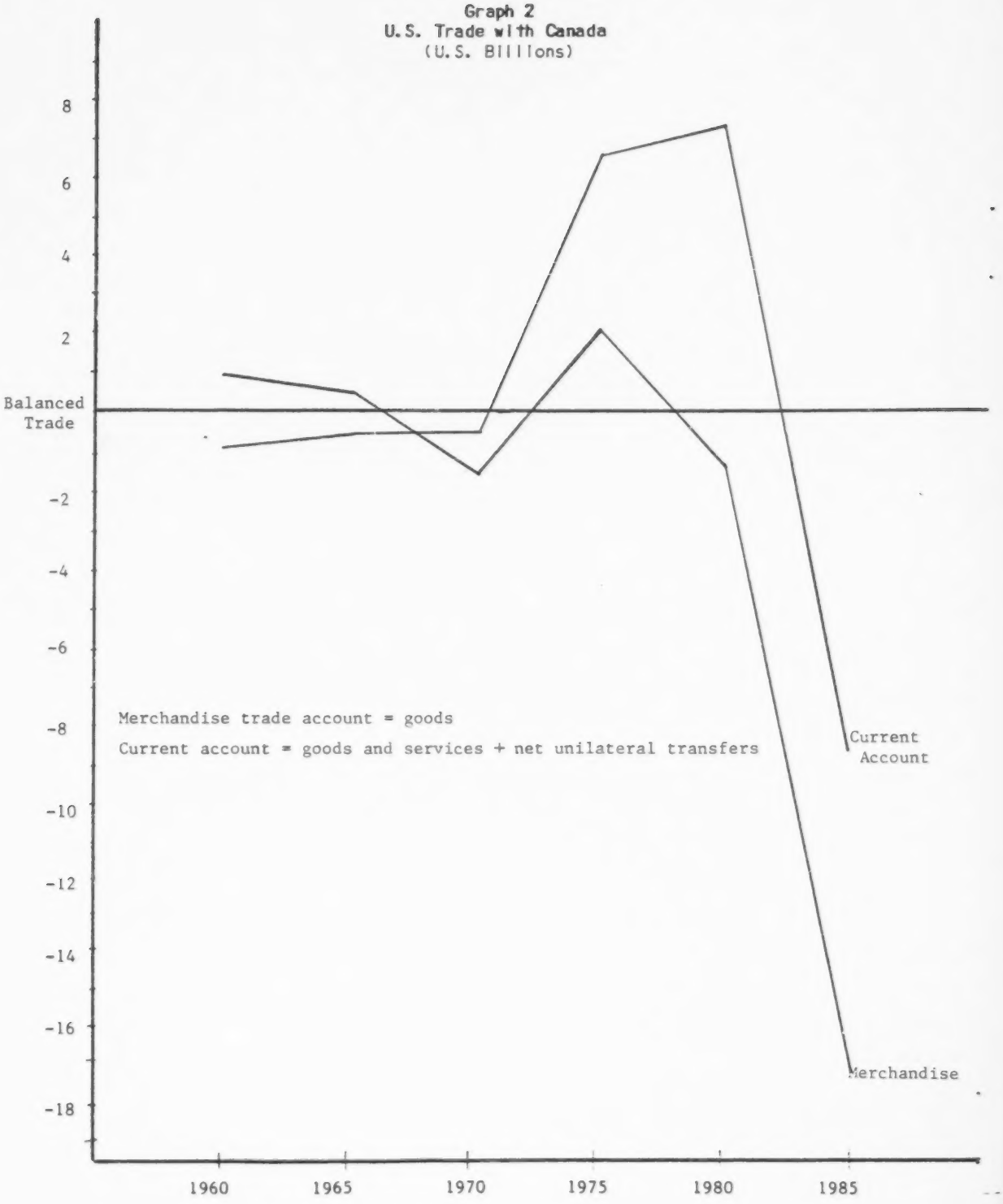
Total of al U.S. Merchandise Exports: $217 billion



U.S. Merchandise Imports - 1986

Total of all U.S. Merchandise Imports: $387 billion

Graph 2
U.S. Trade with Canada
(U.S. Billions)



Source: Congressional Research Service

Table 1
Canadian Imports from the United States by Industry: 1985[1]
(Millions of US Dollars)

Industry	Canadian Provinces					
	Atlantic[2]	Quebec	Ontario	Prairies	Pacific	Total
Live Animals	1.0	7.8	54.0	7.0	7.1	76.8
Food, Beverages, Feed, and Tobacco	81.9	324.0	1,076.0	289.9	394.6	2,166.2
Inedible Crude Materials	37.2	356.2	1,851.0	107.6	125.5	2,477.6
Inedible Fabricated Materials	274.9	1,372.0	6,498.1	709.6	464.5	9,319.5
General Purpose Machinery	29.5	160.8	1,027.2	268.8	104.7	1,591.0
Special Industrial Machinery	91.1	299.1	1,398.1	574.1	176.0	2,538.0
Ag. Machinery & Tractors	16.0	32.3	390.3	558.7	47.2	1,044.3
Transportation Equipment	57.0	1,113.7	12,374.0	1,011.2	461.6	14,657.6
Other Equipment and Tools	97.3	1,267.1	5,960.6	613.4	75.6	8,312.0
Personal & Household Goods	5.8	111.4	414.6	50.4	45.5	627.6
Miscellaneous End Products	33.9	296.6	1,965.7	177.1	171.0	2,644.4
Total End Products, Inedible	330.6	3,281.0	23,530.5	3,253.7	1,381.6	31,777.4
Special Transactions, Trade	9.4	71.1	315.6	73.8	33.6	503.7
Total Exports to the U.S.[3]	735.1	5,412.0	33,325.2	4,441.6	2,406.8	46,320.7

Table 2
Canadian Exports to the United States by Industry: 1985[1]
(Millions of US Dollars)

Industry	Canadian Provinces					
	Atlantic[2]	Quebec	Ontario	Prairies	Pacific	Total
Live Animals	2.2	11.4	111.3	163.2	19.8	307.9
Food, Beverages, Feed, and Tobacco	731.0	458.4	824.8	252.8	155.0	2,422.0
Inedible Crude Materials	88.0	561.2	352.5	7,002.6	607.6	8,612.1
Inedible Fabricated Materials	1,158.9	5,213.3	8,741.8	2,441.4	3,582.5	21,137.8
Industrial Machinery	23.0	198.6	1,255.7	83.3	105.2	1,665.8
Ag. Machinery & Tractors	2.1	8.9	221.9	96.6	7.7	336.9
Transportation Equipment	258.1	2,195.8	22,897.2	183.3	173.2	25,707.6
Other Equipment and Tools	18.4	908.9	2,435.5	178.6	86.4	3,627.7
Personal & Household Goods	1.7	218.4	247.4	15.2	19.8	502.4
Miscellaneous End Products	23.7	334.7	1,034.4	54.9	53.2	1,500.9
Total End Products, Inedible	327.0	3,865.2	28,092.0	611.8	445.6	33,341.6
Special Transactions, Trade	3.3	8.5	45.8	35.0	10.4	103.1
Total Exports to the U.S.[3]	2,310.5	10,118.2	38,168.2	10,506.7	4,820.8	65,924.6

* Totals may not add due to rounding.

1 Figures are f.o.b.
2 The Atlantic Provinces are defined as New Brunswick, Newfoundland, Nova Scotia, and Prince Edward Island; the Prairies as Alberta, Manitoba, and Saskatchewan; and the Pacific Provinces as British Columbia, the Northwest Territory, and the Yukon Territory.
3 Figures do not include Puerto Rico or the U.S. Territories.

Source: Statistics Canada - International Trade Division.

III. Structure and Constraints of Canadian Industry and Market

Unlike U.S. producers, Canadian manufacturers are limited by a small domestic market in achieving economies of scale through large scale production. Particularly in the consumer durables industry, they have tended to produce a wide range of goods, each in a relatively small quantity, in order to provide product choices for the Canadian market. The Canadian automotive industry in the early 1960's is a case in point. Automakers were producing low volumes of a wide range of models, which meant operating under fragmented production runs. This inefficiency, along with an attempt to avoid a U.S. countervailing duty, spurred Canada to sign the Auto Pact in 1965. In this context, the Auto Pact was originally designed to allow specialization in order to increase production efficiency. Another example is the food and beverage industry, where production costs are an estimated 50 percent higher than in the U.S., simply due to the industry's inability to achieve scale economies in the Canadian market.

Addressing the inefficiencies created by such small scale production has been the major force behind Canadian commercial policy. Despite its concern, however, the Canadian Government has reinforced this inefficient, fragmented production pattern by implementing high tariffs and other trade barriers that effectively create an insulated, high-priced market which allows domestic producers to operate profitably. In many instances, though, tariffs have been necessary for a Canadian industry to survive. According to a report based on research that examined 167 manufacturing industries in Canada, industries with high tariffs had shorter production runs and greater product diversity than other industries. As tariffs were reduced, the report found that production runs lengthened and product diversity within plants decreased.

In general, Canada's tariff structure consists of free rates in raw materials and progressively higher duties for more value-added processed goods, which is where the greatest trade opportunities exist between the two countries. Although over 80 percent of U.S. goods exported to Canada enter duty-free, tariffs on the remaining U.S. imports average twice the amount of U.S. tariffs for comparable Canadian imports, making them among the highest in the industrialized world.

Table 3 compares tariffs for major manufactured items in the two countries. As the table shows, the Canadian manufacturing sector receives considerably stronger tariff protection. For most of the products listed, Canadian tariffs are double or triple U.S. tariffs. Economists in the U.S. and Canada agree that if tariffs in Canada are eliminated, many U.S. based multinational companies will move production from Canada to larger facilities in the U.S. in order to serve both markets more efficiently. This shift has important implications for many industries in both countries, which is discussed later in the report.

Canadian tariffs, however, are not the only culprit behind the inefficient production occurring in many Canadian industries. U.S. tariffs and other trade barriers also have encouraged Canadian manufacturers to produce primarily for the Canadian market by limiting their access to the large U.S. market. All of this suggests that the present bilateral trading arrangement for many manufactured products has promoted considerable inefficiencies, particularly in the Canadian marketplace. Trade liberalization should contribute toward improving the competitiveness of Canadian industry in the long-run.

Table 3
Tariffs by Industrial Sector, post-Tokyo Round: 1987
(ad valorem)

Industry	Canada	United States
Textiles	16.9	7.2
Clothing	23.7	18.4
Leather Products	4.0	2.5
Footwear	21.5	9.0
Wood Products	2.5	0.2
Furniture and Fixtures	14.3	4.6
Paper Products	6.6	0.0
Printing and Publishing	1.1	0.3
Chemicals	7.9	0.6
Petroleum Products	0.4	0.0
Rubber Products	7.3	3.2
Non-metal Mineral Products	4.4	0.3
Glass Products	6.9	5.7
Iron and Steel	5.1	2.7
Non-ferrous Metals	3.3	0.5
Metal Products	8.6	4.0
Non-electrical Machinery	4.6	2.2
Electrical Machinery	7.5	4.5
Transportation Equipment	0.0	0.0
Miscellaneous Manufactures	5.0	0.9

Note: Canadian tariff averages are weighted by imports from the United States and vice versa.

Source: The United States Trade Representative.

IV. The Bilateral Trade Pact

Consistent with principles established under the GATT, Canadian and U.S. trade negotiators are taking a non-sectoral approach to talks, meaning that all sectors are included in a trade agreement at the outset of negotiations. When asked by the United States Trade Representative (USTR), however, a majority of U.S. industries favored bilateral negotiations on a sector-by-sector basis, presumably to ensure that certain safeguards were retained or created under an agreement. These industries include aluminum products, home appliances, cosmetics, electrical equipment, furniture, informatics, leather, agriculture equipment, printing, and fabricated steel. This push for a sectoral approach shows that these industries realize they have much at stake in negotiating a bilateral pact. In addition to preventing the proliferation of industry-specific safeguards, a non-sectoral approach forces both countries to bring to the negotiating table issues which they prefer left untouched (such as the Auto Pact in the case of Canada and government procurement in the case of the U.S.), which are often the most protective trade arrangements.

Gains For Canada

The fear of more protectionist trade proposals legislated in the U.S. is the primary reason the Mulroney Administration initiated bilateral discussions. The most important goals for the Canadian negotiators are as follows:

- Obtain assurance of protection from U.S. trade remedy actions, specifically dumping and countervailing duty (CVD) laws, which they perceive the U.S. to use discriminatorily. Canadian government and industry officials assert that under the present system, it is impossible to know which Canadian government programs are a potential target for American trade actions.

- Secure access to the large American market for Canadian products before the U.S. Congress imposes more limits on imports, and improve access by lowering tariff and non-tariff barriers in the United States.

- Increase Canada's negotiating leverage with its other trading partners. Any concessions agreed to between Canada and the U.S. will automatically be available to other trading partners (although they must still be negotiated) under the Most-Favored-Nation (MFN) provision of the GATT. (If Japan and the European Community want the same concessions agreed to under the U.S.-Canada trade pact, they will have to meet some of Canada's requests when they negotiate new bilateral agreements.)

With respect to concern over U.S. trade remedy laws, Canada is especially sensitive to the possibility that U.S. CVD law will interfere with Canadian social policies such as unemployment insurance and regional development programs, which are at the heart of what Canada defines as "cultural sovereignty." The U.S. Government will be watching carefully for programs and policies in which Canada uses "cultural sovereignty" to justify protectionist or unfair trading practices.

Gains For the United States

Since U.S. firms already enjoy economies of scale by producing for the large U.S. market, increased access to Canada would do little for the average American company in the way of promoting production efficiency, especially in view of the size of the northern market, which is roughly one-tenth the size of the U.S. market. Nevertheless, with an annual per capita income of about $12,000, Canada offers an attractive market, especially for U.S. firms located near the Canadian border, where an estimated 80 percent of Canadians live. For companies based in Cleveland, Chicago, or Detroit, for example, Ontario and Quebec are viable markets. In fact, the greatest opportunities for increased trade resulting from a removal of trade barriers exist for states in the Northeast-Midwest Region, where most of the bilateral trade activity already occurs. Two major U.S. objectives for a bilateral trade pact stand out:

- Increase market opportunities for U.S. business by removing or significantly reducing tariffs and non-tariff barriers in investment, services, agriculture, and automotive sectors, among others. Subsidies and other distortive trade programs at the provincial level are particularly targeted.

- Use the bilateral pact to send a signal to other trading partners that the U.S. is serious about liberalizing world trade.

V. Profile of Canadian Trade Activity with the Northeast-Midwest Region

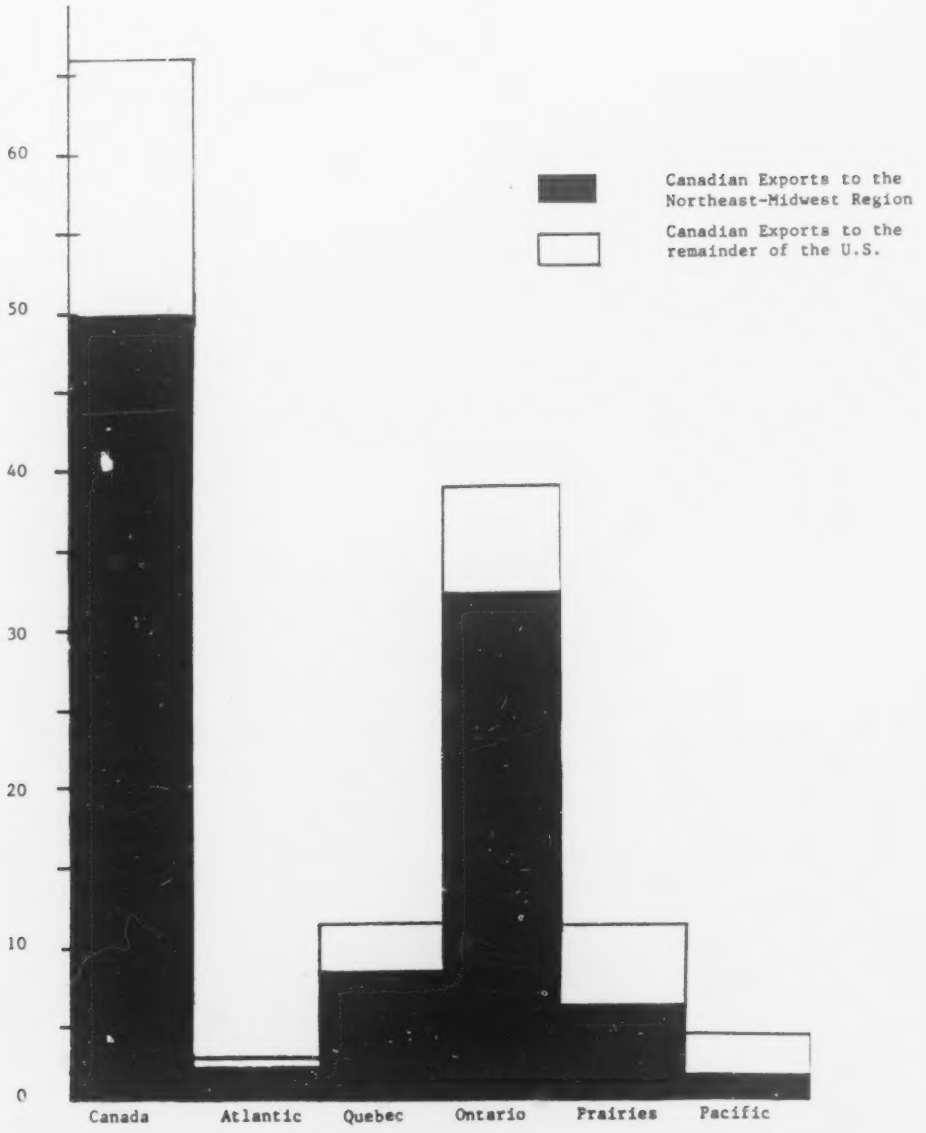
The Northeast-Midwest is the most important region in the U.S. in trade with Canada, both in terms of volume and value of exports and imports, as shown in Graphs 3 and 4. According to Statistics Canada, Canadian exports to the region grew to $50 billion in 1985, representing 76 percent of total Canadian exports to the United States. The major goods shipped to the region include motor vehicle parts, trucks, telecommunications equipment, natural resource products such as softwood lumber, petroleum and coal products, crude petroleum, newsprint paper, and fish. A summary of the region's trade volume with Canada by state is provided in Table 4. Tables 5 and 6 list the volume of state trade with Canadian provinces for 1985. Trade data presented in the following tables are from Canadian sources, which have been converted into U.S. dollar values.

Canadian imports from the region reached $32 billion in 1985, or 70 percent of total Canadian imports from the U.S. The leading Canadian imports from the Northeast-Midwest Region include such manufactured products as computers, electronic tubes and semiconductors, telecommunications equipment, aircraft engines and parts, plastic materials, measuring instruments, and miscellaneous equipment. The region also exports precious metals and chemicals to Canada. A breakdown of the ten leading export and import sectors and their dollar value by state are provided in Attachment A of the Appendix.

Graph 3

Canadian Exports to the U.S. - 1985

(U.S. Millions)

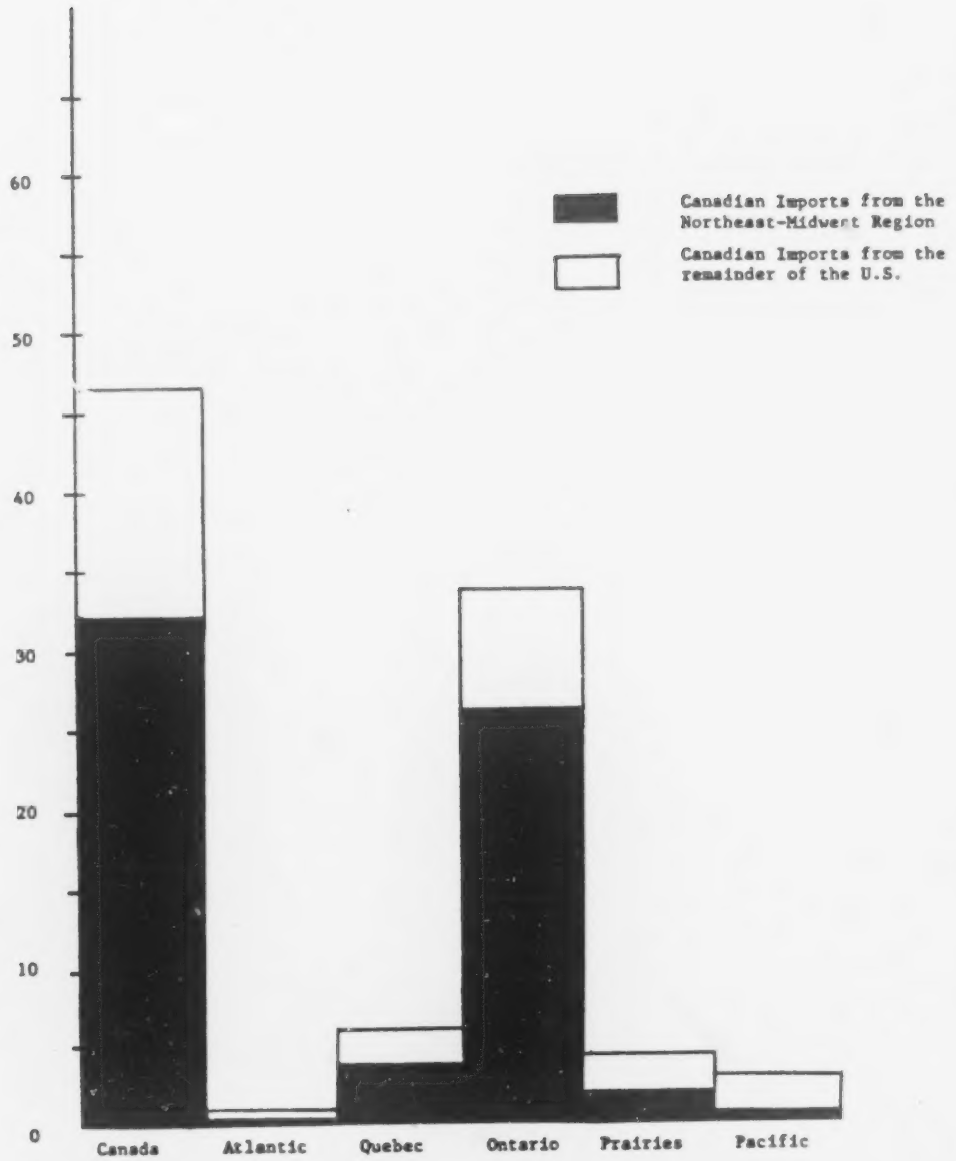


SOURCE: Compiled by Northeast-Midwest Coalition staff based on data from Ontario Ministry of Industry, Trade, and Technology (Attachment).

Graph 4

Canadian Imports from the U.S. - 1985

(U.S. Millions)



SOURCE: Compiled by Northeast-Midwest Coalition staff based on data from Ontario Ministry of Industry, Trade, and Technology (Attachment).

Table 4
Summary of Canadian Trade with the Northeast-Midwest Region: 1985[1]
(U.S. Millions)

Region and State	Canadian Exports to NE-MW	Canadian Imports from NE-MW	Trade Balance[2]
New England			
Connecticut	765.0	736.4	-28.6
Maine	742.3	259.1	-483.2
Massachusetts	1,990.4	1,403.5	-586.9
New Hampshire	283.6	156.1	-127.5
Rhode Island	371.2	149.8	-221.4
Vermont	590.1	167.6	-422.5
Total	4,742.3	2,872.8	-1,869.5
Mid-Atlantic			
Delaware	387.0	274.8	-112.2
Maryland	552.4	302.7	-249.7
New Jersey	1,244.3	1,273.3	+29.0
New York	10,926.3	5,052.4	-5,873.9
Pennsylvania	2,015.5	2,115.4	+99.9
Total	15,225.4	9,018.6	-6,206.8
Midwest			
Illinois	3,432.1	2,855.9	-576.2
Indiana	1,360.5	2,192.7	+832.2
Iowa	312.8	506.9	+194.1
Michigan	17,909.6	8,356.6	-9,553.0
Minnesota	2,685.5	814.9	-1,870.6
Ohio	3,058.6	4,438.4	+1,379.8
Wisconsin	1,240.6	1,292.3	+51.7
Total	29,999.6	20,457.8	-9,541.8
Northeast[3]	19,968.0	11,891.4	-8,076.6
Midwest	29,999.6	20,457.8	-9,541.8
Northeast and Midwest	49,967.6	32,349.2	-17,618.4
U.S. Total[4]	65,924.6	46,320.7	-19,603.9

* Totals may not add due to rounding.

1 Figures are f.o.b.
2 "+" equals state surplus with Canada; "-" equals state deficit.
3 Northeast is defined as New England and Mid-Atlantic.
4 Figures do not include Puerto Rico or the U.S. Territories.

Source: Statistics Canada - International Trade Division.

Table 5
Canadian Exports to the Northeast-Midwest Region: 1985[1]
(U.S. Millions)

Region and State	Canadian Provinces					
	Atlantic[2]	Quebec	Ontario	Prairies	Pacific	Total
New England						
Connecticut	40.8	393.0	255.6	34.0	40.9	765.0
Maine	470.5	149.8	87.7	18.7	15.7	742.3
Massachusetts	712.3	573.6	589.9	19.6	95.1	1,990.4
New Hampshire	49.6	148.7	64.5	2.6	18.2	283.6
Rhode Island	17.9	76.5	260.5	3.5	12.8	371.2
Vermont	7.2	292.7	266.2	13.0	10.9	590.1
Total	1,298.2	1,634.1	1,524.4	91.4	193.6	4,742.3
Mid-Atlantic						
Delaware	6.8	31.7	319.4	13.0	16.0	387.0
Maryland	25.8	177.2	295.5	9.9	43.9	552.4
New Jersey	75.4	478.2	630.6	54.9	105.2	1,244.3
New York	286.0	2,273.0	7,318.7	737.9	310.5	10,926.3
Pennsylvania	144.3	637.2	1,125.8	46.6	61.6	2,015.5
Total	538.3	3,597.4	9,690.1	862.2	537.1	15,225.4
Midwest						
Illinois	33.4	411.3	1,469.9	1,441.5	92.2	3,432.1
Indiana	3.2	200.8	549.0	561.2	46.4	1,360.5
Iowa	0.8	39.1	123.0	137.8	12.1	312.8
Michigan	26.7	1,666.8	15,300.0	864.3	51.8	17,909.6
Minnesota	5.7	42.2	399.4	2,109.3	129.0	2,685.5
Ohio	18.5	425.6	2,197.1	334.6	82.7	3,058.6
Wisconsin	25.6	88.4	793.8	176.7	156.1	1,240.6
Total	97.8	2,874.2	20,832.2	5,625.4	570.3	29,999.6
Northeast[3]	1,836.5	5,231.5	11,214.5	953.6	730.6	19,967.7
Midwest	97.8	2,874.2	20,832.2	5,625.4	570.3	29,999.6
Northeast-Midwest	1,934.3	8,106.0	32,046.7	6,579.1	1,300.9	49,967.6
U.S. Total[4]	2,310.5	10,118.2	38,168.2	10,506.7	4,820.8	65,924.6

* Totals may not add due to rounding.

1 Figures are f.o.b.
2 The Atlantic Provinces are defined as New Brunswick, Newfoundland, Nova Scotia, and Prince Edward Island; the Prairies as Alberta, Manitoba, and Saskatchewan; and the Pacific Provinces as British Columbia, the Northwest Territory, and the Yukon Territory.
3 Northeast is defined as New England and Mid-Atlantic.
4 Figures do not include Puerto Rico or the U.S. Territories.

Source: Statistics Canada - International Trade Division.

Table 6
Canadian Imports From the Northeast-Midwest Region: 1985[1]
(U.S. Millions)

Region and State	Canadian Provinces					
	Atlantic[2]	Quebec	Ontario	Prairies	Pacific	Total
New England						
Connecticut	15.2	242.4	424.4	27.9	26.4	736.4
Maine	64.1	127.9	61.8	2.3	3.3	259.4
Massachusetts	70.5	315.6	950.1	46.6	20.7	1,403.5
New Hampshire	6.7	49.5	93.0	5.0	2.0	156.1
Rhode Island	2.9	48.6	90.3	4.8	3.1	149.8
Vermont	1.3	118.2	43.9	3.2	1.0	167.6
Total	160.6	902.2	1,663.6	89.8	56.4	2,872.8
Mid-Atlantic						
Delaware	1.8	30.8	226.2	11.2	4.8	274.8
Maryland	3.4	38.2	246.6	9.2	5.4	302.7
New Jersey	21.7	286.8	888.1	48.4	28.3	1,273.3
New York	39.7	1,097.5	3,741.4	99.6	74.1	5,052.4
Pennsylvania	31.5	278.0	1,644.7	115.6	45.6	2,115.4
Total	98.1	1,731.2	6,747.1	284.0	158.3	9,018.6
Midwest						
Illinois	33.4	275.6	1,941.3	430.7	175.0	2,855.9
Indiana	8.2	107.1	1,924.8	98.4	54.3	2,192.7
Iowa	3.9	31.8	260.9	188.2	22.1	506.9
Michigan	13.9	351.6	7,891.2	61.4	38.4	8,356.6
Minnesota	6.8	51.8	500.3	233.0	23.1	814.9
Ohio	24.7	214.5	3,987.0	151.5	60.9	4,438.4
Wisconsin	11.5	104.5	883.7	237.9	54.6	1,292.3
Total	102.4	1,136.7	17,389.2	1,401.1	428.3	20,457.8
Northeast[3]	258.7	2,633.4	8,410.6	373.8	214.6	11,891.4
Midwest	102.4	1,136.7	17,389.2	1,401.1	428.3	20,457.8
Northeast-Midwest	361.0	3,770.0	25,799.8	1,774.9	642.9	32,349.2
U.S. Total[4]	735.1	5,412.0	33,235.2	4,441.6	2,406.8	46,320.7

* Totals may not add due to rounding.

1 Figures are f.o.b.
2 The Atlantic Provinces are defined as New Brunswick, Newfoundland, Nova Scotia, and Prince Edward Island; the Prairies as Alberta, Manitoba, and Saskatchewan; and the Pacific Provinces as British Columbia, the Northwest Territory, and the Yukon Territory.
3 Northeast is defined as New England and Mid-Atlantic.
4 Figures do not include Puerto Rico or the U.S. Territories.

Source: Statistics Canada - International Trade Division.

VI. Trade with Ontario

As the industrial heartland and manufacturing center of Canada, Ontario boasts the greatest commercial activity of Canadian trade with the United States. Exports from Ontario represented about 58 percent ($38 billion) of Canada's total goods shipped to the U.S. and about 61 percent ($33 billion) of U.S. imports into Canada in 1985, as shown in Tables 1 and 2. About 91 percent of Ontario's exports went to the U.S. during that year. When considered alone, the province is the United States' third largest trading partner, following Canada as a whole and Japan.

As Tables 5 and 6 show, the greatest portion of the Northeast-Midwest Region's bilateral trade with Canada is with Ontario. Ontario exported $32 billion to the region in 1985; this represents 64 percent of Canada's total export shipments to the region (Table 5). Ontario is the most important market for the region's exports, with $26 billion in goods shipped to the province in 1985, as shown in Table 6. This figure represents 80 percent of total Canadian imports from the region.

This concentration of trade activity in Ontario means that the province has the most at stake in negotiating a bilateral free trade agreement, which could explain why, of all the provinces, it is the least favorable toward an agreement. The western provinces, in contrast, primarily export natural resource products, and have historically wanted freer trade in order to increase their purchases of manufactured goods.

The Government of Ontario has stated that it expects to share negotiating authority over trade policy with the Canadian Federal Government. Ontario's greatest issue of concern in trade talks is most likely the automotive sector, which represents over 50 percent of the province's exports and about 40 percent of its imports. Virtually all of this automotive trade is with the United States.

VII. Industry Adjustment

A broad free trade agreement would require some industries to contract and others to expand in both Canada and the U.S., since in the absence of heavy protection market forces will determine the production of goods based more closely on comparative advantage. The contraction needed would result in two types of short-term adjustment (defined as lasting between five and ten years): adjustment within industries, where there is the most room to specialize in Canada; and adjustment between industries, or inter-industry adjustment. The latter adjustment is the most painful type because of its disruptive effects on unemployment.

Successful adjustment in many Canadian industries will depend upon the federal government's ability to implement policies that will promote internal reorganization within industries and particularly between provinces. The trade agreement must be specifically designed to address implementation problems at the provincial level if it is to be effective. The following highlights the effect the pact will have on some major North American industries.

Consumer Goods -- U.S. industries that are expected to immediately benefit from the bilateral pact include household furniture, household appliances, footwear, and petrochemical products. These industries currently face high tariffs at the Canadian border (shown in Table 3), which would be removed or at least lowered under the trade agreement. Within the furniture industry, the Canadian office furniture industry would be in a good position to expand under a bilateral free trade agreement. In contrast, producers of household furniture, who have had to cater to more varied consumer tastes, would need to undergo some major adjustments because the industry is fragmented, with many small plants that cannot expand output to efficient rates of production. This adjustment would probably require several plant closings in Canada while others were expanded.

Urban transportation equipment is another strong candidate for expansion in Canada. As Table 3 shows, this equipment is not protected by tariffs. However, the Canadian industry currently depends on government procurement procedures, which is something the trade negotiations are designed to reduce.

In the textiles and apparel industries, it is unclear whether the U.S. or Canada enjoys a comparative advantage. The U.S. textile industry expressly stated its opposition to a bilateral free trade agreement. Its primary concern is that lowering barriers will allow other countries to circumvent U.S. textile quotas by shipping through Canada.

Natural Resources -- The trade pact will likely improve Canada's competitiveness for pulp, paper, and lumber products, according to the ITE report. Producers of these goods will probably increase their share of the U.S. market. Substantial changes are needed internally, however, before the Canadian natural resource sector can fully benefit from liberalized trade. For example, Canada's paper industry, while enjoying access to cheap raw materials, is severely limited by outdated paper-making machinery. According to a report by the Canadian Royal Commission, about 50 percent of the industry's machinery currently in use in Canada was made before 1950, compared to 25 percent in the U.S., and only 5 percent in Scandinavia.

As a world class producer, the U.S. paper industry has a comparative advantage with Canada, according to the American Paper Institute (API). Canadian imports of U.S. paper, paper board, and converted products account for $465 million, or 18 percent of the U.S. industry's production. Meanwhile, Canada is a big producer of newsprint, sourcing over 60 percent of U.S. consumption. With the exception of Vermont, newspaper print is one of the ten leading commodities imported from Canada for every state in the Northeast-Midwest (Attachment A in the Appendix). Although trade in newsprint flows duty-free between the two nations, the U.S. exports very little of the product. With respect to the paper industry, API has two major concerns in the trade talks:

- Increase access to the Canadian market by eliminating Canadian duties across the board. API is strongly opposed to removing tariffs on a product-by-product basis. Of particular concern are tariffs as high as 10 percent, which affect small companies located in the northeast who produce specialty grades of paper.

- Remove Canadian subsidies such as low interest loans or forgiven loans for expansion of large capacity mills.

Steel -- Canadian steelmakers such as Stelco Inc. and Dofasco Inc. are generally considered to be more efficient producers than their U.S. counterparts. Nevertheless, expansion in Canadian steel exports to the U.S. is highly unlikely to result from the negotiations. U.S. steel trade with Canada remains a sensitive issue following last year's surge of steel imports into the U.S. despite a "gentlemen's agreement" that was designed to prevent significant growth in Canadian steel imports. This issue is addressed in more detail in the steel section below.

VIII. Key Sectoral and Bilateral Trade Issues

Subsidies

One of the most important issues on the table for the United States is Canadian subsidies. The key factor in determining the existence of a subsidy is "general availability" as defined by the Subsidies Code of the GATT. If a Canadian federal or provincial program is not generally available throughout Canada and for all industries, the U.S. Administration maintains that it is an export subsidy subject to countervailing duties. Canada has argued that the U.S. stretches the definition of an export subsidy too far.

Subsidies may be broadly classified as domestic or export subsidies. Government payments to an industry or firm that are tied to export performance, or export credits granted by a government at interest rates below what the government paid, are examples of export or foreign subsidies, which are illegal under the GATT Subsidies Code. The U.S. CVD law is designed to safeguard the rights of U.S. producers against such foreign subsidies. Under the Subsidies Code, domestic subsidies may be used to promote social and policy objectives such as assistance to depressed regions. However, if a domestic subsidy causes damage to the industry of another country, it may be labeled an unfair trade practice and be subject to countervailing duties.

Although subsidies are not the biggest deterrent to efficient trade, they are one of the most politically charged issues, and therefore difficult to address. The U.S. continues to seek the elimination of what it considers the most egregious Canadian subsidies, particularly provincial subsidies. The U.S. remains concerned about subsidies for electric power, potatoes, potash and autos, among others. The following examples highlight some of the recent developments surrounding U.S. and Canadian alleged subsidies.

- Since 1980 the U.S. has initiated over 60 trade complaint investigations against Canada. About 13 of these were countervailing duty cases. Subsidies are seen most prominently in the U.S. and Canadian agricultural sectors. With the exception of agriculture subsidies, U.S. subsidies are not a major concern for Canada except as a negotiating tool or defense against U.S. complaints of Canadian subsidies.

- In December 1985, the U.S. reached a settlement on Canadian subsidies of lumber. Shortly after, Canada alleged U.S. subsidies of grain corn, which was followed by a 67 percent tariff on American corn imports in November. This action marked the first time Canada had ever imposed a countervailing duty on a partner. In response, the U.S. Senate unanimously passed a joint resolution requesting the U.S. Administration to conduct an expedited review of Canadian agricultural subsidies.

Automotive Products

Trade in automotive products constituted almost 30 percent of the $149 billion in two-way trade between the U.S. and Canada in 1986. The 1965 U.S.-Canadian Automotive Agreement (Auto Pact) governs substantially all trade in automotive products between the U.S. and Canada, and is one of the most important sectors to be addressed during the negotiations. A brief summary of the Auto Pact and the Duty Remissions Program is provided in Attachment B of the Appendix.

During the past 20 years, dramatic changes have taken place in bilateral automotive products trade. In 1965, the U.S. imported only $76 million in finished vehicles and parts from Canada, while exporting $640 million of these products to Canada. Twenty years later, bilateral automotive products trade had reached $45 billion, producing a $3.6 billion Canadian surplus.

With the exception of 1975, the U.S. has consistently experienced a trade deficit with Canada in the automotive sector since 1968. During this period, the deficit in finished vehicle trade has exceeded the surplus in trade in original equipment parts. The first year that the U.S. is likely to see a deficit in both vehicles and parts is 1987.

In addition, direct investment in North America in recent years by third-country manufacturers, primarily from Japan and Korea, has raised concern about the continued benefits of the Auto Pact to the U.S. Moreover, Canadian resumption of an automotive Duty Remissions Program, which allows a motor vehicle manufacturer that purchases Canadian auto parts for export a reduced duty on its imports of finished vehicles, has raised concern about the use of subsidies to promote exports of Canadian parts.

U.S.-Canadian Auto Pact

The biggest single cause of this growing U.S. trade deficit in automotives is the Auto Pact. The Auto Pact essentially provides an export subsidy for domestic and foreign auto parts exported to the U.S. market from Canada. The inequities of the Auto Pact must be addressed in the ongoing negotiations. If it is left untouched, the U.S. bilateral deficit in auto trade will not be contained.

The Province of Ontario has expressed strong opposition to discussing the Auto Pact during the negotiations since most Canadian production occurs in Ontario. Furthermore, the Canadian Federal Government is reluctant to discuss the Auto Pact because it has reversed a large deficit in automotive trade with the U.S., and allowed for the establishment of a Canadian automotive industry larger than could be supported by the domestic Canadian market. Aspects of Canadian trade policy in automotive products that the U.S. has found discriminatory are described below.

- The revival of the Duty Remissions Program, in conjunction with the Auto Pact, creates an incentive for foreign manufacturers to locate in Canada and export auto parts duty-free to the U.S. market.

- The Auto Pact requires each Canadian-based manufacturer to achieve 60 percent Canadian value added (CVA) in the production of all vehicles in Canada. This provision guarantees a market for Canadian parts, limits

sales by U.S.-based parts suppliers, and ensures that such suppliers locate in Canada in order to sell there.

- Canada has implemented the Auto Pact on a "multilateral" rather than a bilateral basis. Canada currently allows a "qualified" manufacturer to import motor vehicles and original equipment parts duty-free from any country.

- The Auto Pact encourages unlimited local foreign production in Canada, which is contributing to the oversupply of autos and auto parts in North America.

The Motor Vehicle Manufacturers Association (MVMA) of the U.S. has testified in support of the Auto Pact. It is their view that the Canadian Government should require all third-country manufacturers making investments in Canada, (specifically Honda, Hyundai, and Toyota), to comply with the Canadian production and Canadian value added requirements of the Pact before being allowed to import finished vehicles and parts duty-free into Canada. Canada presently intends to allow such manufacturers duty-free treatment on vehicles and parts imports before the provisions of the Pact are met. Existing Canadian-based manufacturers oppose this action because they lose their competitive advantage in the Canadian vehicle market. That is, the new vehicle manufacturers receive duty-free treatment on vehicle imports, but do not have to meet the provisions of the Pact.

Canadian officials appear divided over whether to force third-country manufacturers to meet the Canadian production and value added requirements. On the one hand, they worry that Canadian-based manufacturers will have no incentive to meet the requirements if third-country manufacturers are not forced to comply with the same provisions. On the other hand, if they impose the requirements, the Canadian Government fears that third-country manufacturers will invest in the U.S., where no such restrictions exist.

The Auto Pact as implemented by Canada encourages third-country manufacturers to increase both imports into Canada and local production, which together contribute to the problem of automotive oversupply in North America. Canadian officials are likely to use the oversupply issue to justify maintaining the safeguard provisions of the Auto Pact. During the April 7 meeting with Members of Congress, visiting Ontario parliamentarians stressed the benefits of "managed trade" embodied in the Auto Pact and even encouraged the application of such managed trade to other sectors such as natural resources.

Duty Remissions Program

The Duty Remissions Program provides a manufacturer that purchases Canadian parts for export reduced duties on its imports of finished vehicles. The Canadian government allows "qualified manufacturers" -- those maintaining a certain level of Canadian production and Canadian value added-- to import finished motor vehicles and parts into Canada duty-free from anywhere in the world. Such vehicles would have little if any U.S. value added. In addition, duty-free import treatment places U.S.-based parts suppliers in no better position vis-a-vis third country suppliers in selling to Canadian-based motor vehicle manufacturers.

The IIE study concludes,

> "that the Duty Remissions Program permits Japanese firms operating in Canada to use exports to the U.S. (which are duty-free under the Auto Pact) as a way to earn the rebate of Canadian duties on imports from Japan. Canadian-based producers are thereby using the duty-free access to the U.S. as a way to reduce barriers to imports from Japan."

The "Big Three" American automakers oppose the Duty Remissions Program because it provides non-North American producers rebates on duties, which reduce the competitiveness of the "Big Three" in Canada. The U.S. Trade Representative (USTR) has determined that the program is a violation of the GATT because it provides a subsidy for the export of Canadian auto parts.

Agriculture

In 1985, the U.S. imported 27 percent of Canada's farm products, and Canada remained the United States' fifth largest agricultural customer, with American farm products accounting for roughly 60 percent of Canada's total agricultural imports. Although the chief concerns drawing Canada and the U.S. to negotiations are non-agricultural, numerous agricultural policies urgently need to be addressed. Negotiators will try to harmonize polices in the two countries and establish a common agricultural policy for North America. The most important gains of such a policy will be improved cooperation between Canada and the U.S. in global markets, rather than increased bilateral trade. For example, Canadian farm producers are concerned about the ongoing subsidy war between the U.S. and the European Community. The price war is pushing world prices down and squeezing Canadian exporters out of their traditional overseas markets.

Liberalizing bilateral agriculture trade, however, will be one of the most difficult tasks because of extensive regulation in both countries. The complexity of the sector could jeopardize a bilateral trade pact, which has prompted some economists to recommend that agriculture be considered separately. In the case of agriculture, domestic policies and programs in both countries, rather than tariffs, cause the most distortion in North American trade. Commercial policies in many provinces reflect a goal of self-sufficiency in specific commodities. Subsidies in the form of price and income support and stabilization programs are pervasive; provincial market control boards and technical and health standards also are often used to bar imports. A greater degree of regional specialization within Canada as well as overall trade with the U.S. would occur if some of these interprovincial trade barriers were removed.

While the U.S. Administration's primary goal is to reduce farm support worldwide and develop new trade rules to peacefully settle disputes, realistically, these changes can only be achieved at a multilateral level of negotiations. Still, trade negotiations with Canada are a good place to begin to address agrifood policies because the pact can serve as a model for solving agriculture problems globally.

Canada's heavy reliance on the U.S. market for agrifood exports should logically induce them to seek negotiations to gain assured and improved access to the U.S. market. Canada, however, is reluctant to bring agriculture into the trade talks, while the U.S. is insisting on its inclusion. There are several reasons for Canada's reluctance. Canadian agriculture is more export driven than the U.S., meaning more is at stake. About 50 percent of Canada's farm and food products are exported, compared to 20 percent for the U.S. and the European Community. In addition, the potential benefits gained from improved access to the U.S. market for Canadian farm products are less tangible and more speculative than the predictable negative effects resulting from removing support programs. The drawbacks include lower prices, profits and asset values, as well as the loss of some control over markets enjoyed by producers. And finally, Canada's agricultural sector will require more wrenching adjustments under a trade agreement because it currently enjoys greater protection.

T.K. Warley and R.R. Barichello, Canadian agriculture economists, have identified several fundamental differences between U.S. and Canadian agricultural policy. They noted the following characteristics of Canadian policy:

- Overall higher level of intervention and regulation and less resolve to move toward more market-oriented systems;
- Distinctly higher levels of support for dairy, poultry, horticultural, and red meats;
- Broader commitment to stabilize producers' returns for a wider range of products and to share the down-side marketing risks with farmers;
- More extensive use of explicit supply management techniques involving formula pricing and farm-level quotas;
- Deeper commitment to "orderly marketing" agencies and provincial commodity boards;
- Active involvement of provincial governments in operating their own food sector assistance and development programs, which results in making them equal managing partners with the federal government.

The current balance of trade varies by agricultural sector. Discussed below are the major traded goods and the concerns of bilateral negotiators and farm producers.

Meats -- The greatest portion of bilateral trade in agrifoods is in beef, pork, and live animals, where the U.S. market accounts for over 80 percent of Canadian shipments of these products. In fact, these are the only agricultural sectors where Canada has a significant surplus with the U.S., as seen in Table 7. In contrast to dairy products and grain, beef and hogs receive relatively small amounts of Canadian Federal Government expenditures, and trade in live cattle is essentially free of tariffs and quotas. However, there are a number of provincial government programs for these commodities, including livestock and meat stabilization plans in effect in British Columbia, Manitoba, and Saskatchewan; tax credits for feeding cattle; and low-interest loans available through livestock feeder associations.

Live hogs and pork have been troublesome sectors for bilateral trade in the past few years. The U.S. has two major complaints with respect to Canadian trade practices: subsidization of hogs and restrictive health requirements at the border. In 1985, the U.S. imposed a countervailing duty in response to finding subsidies on Canadian hog exports which injured U.S. producers. Canadian health and inspection requirements are probably a bigger problem though. A 30-day quarantine requirement on live hog imports effectively eliminates U.S. exports of slaughter hogs to Canada.

In many North American agricultural sectors, the U.S. holds the market power because of its relative size, making Canada the price taker in agricultural products. This is particularly the case for beef and pork. U.S. producers would likely not suffer if access to the U.S. market were increased for these Canadian exports under a free trade agreement.

Dairy, Poultry and Eggs -- These products receive the greatest protection and overall regulation in Canadian and U.S. agriculture, which has kept bilateral trade flows in the sector small. The Canadian dairy sector receives the second highest amount of government funding behind grain, mostly in the form of price supports for milk products. An import embargo on margarine also protects dairy producers against foreign competiton. Fluid milk imports into Canada are restrained by health and sanitary regulations and import licensing requirements, while the U.S. imposes marketing order regulations and quotas. National supply control programs in Canada determine national production and import quotas for chicken, turkey, and table eggs, and their quota allocations among provinces. How the quotas are divided reflects provincial negotiating power, rather than economic criteria such as lowest cost production.

Understandably, dairy, poultry and egg producers voiced the strongest opposition to being included in free trade negotiations. According to a report by M.A. Normile, C. Goodloe, and R. House, economists with the U.S. Department of Agriculture (USDA), Canadian producers in these sectors are not competitive in either the U.S. or third-country markets. But if restrictive measures were relaxed, regional differences in costs and efficiencies could result in increased bilateral trade. Wisconsin and Minnesota, for example, would likely have a cost advantage in shipping dairy products to western Canada and parts of eastern Canada, while dairy shipments from Quebec to the northeastern United States would naturally expand. The USDA economists conclude:

> "Domestic policies and border measures have the effect of thwarting what would probably be the 'natural' flow of products north and south across the border, rather than shipments across long east-west distances within each country. Commodities with relatively few barriers are traded liberally between adjacent regions across the border."

Grains -- Grain is the leading agricultural commodity exported from Canada. As Table 7 indicates, the U.S. market accounts for about 53 percent of Canada's global shipments of grain and grain products, which primarily include feeds, fodders, and bakery products. Although both countries are big wheat producers, most wheat exports are destined for third markets since heavy government regulation in the U.S. and Canada precludes significant bilateral trade in wheat. Barley accounts for a large portion of the grain trade figures shown in Table 7. More trade exists in barley than wheat because U.S. target

Table 7
Canada's Total Trade and Agricultural Trade with the United States: 1984[1]
(Millions of US Dollars)

Commodity	Canadian Exports	Canadian Imports	Trade Balance[2]	Percentage of Total Exports[3]
All Commodities	60,634	50,192	-10,442	-----
Agricultural Products	1,637	2,643	+1,006	21.7
Grains and Products	154	223	+69	53.0
Animal Feeds	28	56	+28	47.8
Oilseeds and Products	69	348	+279	20.2
Live Animals	322	40	-282	90.4
Beef and Pork	395	117	-278	71.9
Other Animal Products	44	168	+108	22.8
Dairy Products	10	10	0	5.8
Poultry and Eggs	19	79	+60	51.6
Fruits and Nuts	51	617	+566	65.3
Vegetables excluding Potatoes	62	387	+325	40.0
Potatoes and Products	36	26	-10	50.3
Seeds	14	38	+24	63.2
Maple Products	15	0	-15	83.2
Sugar	29	23	-6	95.8
Tobacco	20	6	-14	24.1
Other	278	492	+214	79.1

1 Figures are f.o.b.
2 "+" equals U.S. surplus with Canada, "-" equals U.S. deficit.
3 Figures represent Canadian agricultural exports to the U.S. as a percentage of Canada's total exports by commodity group: 1984.

Source: Statistics Canada - Agricultural Division.

prices are lower for barley, which encourages less domestic barley production, higher U.S. prices, and therefore more imports.

The Canadian Wheat Board (CWB) is the sole exporter of wheat, barley and oats. The CWB severely restricts trade in these grains by limiting the number of import permits granted. These licenses are given only when the domestic grain supply is considered inadequate. The CWB also implements producer marketing quotas, which are used to spread grain deliveries over the marketing year. The CWB maintains a two-price system for domestically consumed and exported wheat. This system is incompatible with a free trade agreement.

Collaborative research by Canadian and American agricultural economists, A. Schmitz, C. Carter, and G.C. Van Kooten, found that the Canadian grain sector receives the greatest amount of federal government spending in agriculture. They identified several programs that effectively subsidize grain, including income guarantees for contributing farmers through the Western Grain Stabilization Act; deficiency payments when grain prices fall below the initial CWB payment; provincial crop insurance schemes, which help participating farmers whenever crop yields fall below past average yields; and regulated rates for rail shipments for prairie grain producers, which amount to about $660 million annually. Removing freight subsidies would mean a much larger portion of Canadian grain would likely be shipped to export markets by way of the U.S. barge system (especially on the St. Lawrence Seaway) and by U.S. rail. It also would likely increase U.S. exports of feed gains, primarily corn, to eastern Canada.

Horticulture Products -- Fresh fruits, vegetables, and nuts are the second most bilaterally traded agricultural goods, behind meat and live animals. The U.S. enjoys a large trade surplus, with Canada importing over US$1 billion in produce from the U.S., mostly due to the shorter growing seasons in the north. Canada frequently imposes seasonal tariffs ranging from 10 to 20 percent on these products to reduce heavy U.S. competition. Although trade in horticulture products does not have many of the distortive trade restrictions discussed earlier, U.S. processors are frustrated with the plethora of Canadian regulations (including metric packaging and bilingual labeling requirements). In addition, health and sanitary requirements are used to bar many U.S. horticulture products. According to research done by Normile, Goodloe, and House,

> "Free trade would reduce the power of provincial fruit and vegetable marketing boards to negotiate prices and to control market flow... and, barring a realignment of the exchange rate, current patterns of trade would be reinforced by a relaxation of border restrictions".

Wine and Malt Beverages -- The U.S. is a net importer of wine and beer from Canada. Sales of Canadian beer and ale have soared in the U.S. market in recent years, while wine imports remain negligible. Canadian tariff and non-tariff barriers to U.S. wine and beer imports are a major concern for the U.S. and a good example of distortive provincial practices. Although Canada is the largest market for American wine exports, U.S. sales in Canada have dropped, while Canadian wine consumption has increased nearly 45 percent since 1982. According to a report by Inside U.S. Trade, several discriminatory trade practices in Canada govern wine and beer imports:

- Provincial liquor control boards, which control the distribution of domestic and imported alcoholic beverages, allow Canadian wines and beer to be distributed more widely and in greater variety in Canadian retail outlets, while some provinces bar American imports from grocery stores or restrict them to state-run liquor stores.

- Provincial governments mark up (or tax) imported wines much higher than domestic wines. In Ontario, for example, imported sales are marked up 66 percent, compared to only 1 percent for locally bottled wine and beer. Some provinces also assess per-bottle handling surcharges on imported wines.

- All domestic and imported wines must be listed with the provincial control boards, a requirement the boards use to effectively block U.S. sales by granting many more new listings for domestic wines than imported wines. This discriminatory practice is getting worse. In Ontario last year, U.S. wines accounted for 3.9 percent of the listings, down from 5.3 percent the previous year. Moreover, an estimated 17 applications for new listings for U.S. wine were filed between 1981 and 1984, but none were accepted.

- Ontario and British Columbia maintain mixing regulations that limit the foreign grape content for domestically produced wines. With the exception of years of domestic grape shortage, Ontario has used this provision to virtually ban imported grapes for wine production.

Electronics and Telecommunications

Electronic components and products and telecommunications equipment represent an important sector for U.S. and Canada, with bilateral trade reaching $7.5 billion in 1985. According to the American Electronics Association (AEA), Canada and the European Community are the only countries with which the U.S. electronics industry enjoys a surplus. U.S. exports of electronics to Canada were valued at $4.9 billion, while imports totaled $2.6 billion in 1985. This surplus is in sharp contrast with the American industry's global position, which has deteriorated from a surplus of $7.4 billion in 1980 to a deficit of $8.8 billion in 1985.

The strong U.S. trade performance in electronics products with Canada is particularly reflected in the Northeast-Midwest Region. Data for the ten leading U.S. exports and imports with Canada (Attachment A in the Appendix) show the region running an electronics trade surplus of over $1.8 billion with Canada (this does not include telecommunications equipment). Most trade activity is concentrated in U.S. exports of computers, tubes, semiconductors, and measuring instruments to Canada. The region imports negligible amounts of electronics products from Canada, as shown in Attachment A.

Within the telecommunications industry, major changes are needed in Canada to bring it to a "level playing field" with the U.S. The Canadian industry enjoys a virtually closed market as a result of an intercompany supply arrangement between Bell Canada, a publicly owned telephone operating company, and Northern Telecom, Canada's largest telecommunications manufacturer. This arrangement has kept U.S. manufacturers out of an estimated 60 percent of the Canadian telecommunications network equipment market. In the remaining segment of the market, U.S. manufacturers must retain earnings in Canada and use Canadian goods, services, and resources in manufacturing.

In the telephone equipment sector, U.S. sales in Canada have increased steadily each year, reaching $655 million in 1984. Canadian imports, however, have declined in recent years, accounting for only 3 percent of consumption in 1984. As the opportunities for U.S. imports and investment in the Canadian telecommunications industry have declined, just the opposite has occurred in the U.S. market, which is completely open to foreign competition. In fact, U.S. imports of telecommunications equipment have expanded rapidly to $3.4 billion in 1985, according to AEA.

Telecommunications equipment is a leading sector in bilateral trade between Canada and many states in the Northeast and Midwest. It is one of the top ten traded commodities (including export and import activity) for New York, Massachusetts, New Hampshire, Illinois, Iowa, and Indiana. As shown in Attachment A, these states exported an estimated $254 million in telecommunications equipment to Canada in 1985, while importing $606 million of comparable products from Canada. Overall, the region recorded a deficit in telecommunications trade of approximately $373 million in 1985, with exports from the region valued at $319 million, and imports from Canada to the region valued at $692 million.

The American Electronics Association identifies the following concerns with respect to a bilateral free trade agreement:

- Tariffs -- Canadian tariffs for most finished electronics products are high, up to 17 percent in some cases. These tariffs effectively discourage U.S. exports of higher-value assembled products. Canada also gives preferential tariff treatment to British Commonwealth countries (excluding Great Britain and Ireland) and low-cost East Asian suppliers under a General Preferential Tariffs Program (the Canadian counterpart to the U.S. GSP Program).

- Rule of Origin -- The U.S. wants Canada to establish adequate customs measures to ensure that goods from third countries do not benefit from trade liberalizations under the bilateral agreement. A rule of origin would require that a certain percentage of product manufacturing or assembly be done in North America to prevent diversions that circumvent tariffs.

- Standards and Certification -- All electronics imports (including telecommunications equipment) entering Canada must be approved by the Canadian Standards Association (CSA). The American Electronics Association sums up CSA's operations in the following way:

  > "CSA, once controlled by Canadian manufacturers, is now a large and growing bureaucracy which operates in a closed, non-transparent manner. CSA's standards-writing and certification processes operate as a nontariff barrier: new or small U.S. firms unfamiliar with the CSA bureaucracy, who cannot afford to fund CSA (through subscribing membership or donations), or who do not participate on CSA committees are, in effect, denied national treatment with respect to access to the process and decisionmakers."

AEA recommends that U.S. negotiators push Canada to accept U.S. certified and approved equipment for use in Canada. The trade association also wants a more transparent, less bureaucratic regulatory climate that more fairly reflects what Canadian firms face in the U.S. market.

Services and Investment

The U.S. is seeking to include sectors that are currently not covered by a trade agreement with Canada. Specifically, the U.S. is focusing on services and investment, two broad sectors that have experienced enormous growth. Services are broadly defined to include travel, transportation, fees and royalties, insurance payments, investment income, and other government and private services. Bilateral trade talks in services will likely focus on data processing, advertising, broadcasting, trucking, banking, transborder data flows, and telecommunications services.

Services currently account for the largest portion of the U.S. and Canadian economies, yet there are no internationally agreed upon principles to govern service trade or investment. The bilateral talks provide an excellent opportunity to draft such principles. Among other things, the agreement should provide for national treatment of imported services, dispute settlement procedures, and codes to prevent barriers that limit growth in services.

In the area of foreign investment, U.S. concerns include unfair practices in Canada in the form of investment incentive policies and local content requirements, and performance and export requirements. Currently, investment is regulated by Investment Canada, the federal investment agency that places conditions on the type of direct investment allowed in Canada. U.S. financial firms want to be able to invest in Canada without needing approval from this agency. In addition, the U.S. wants Canadian federal subsidies and other incentives for attracting direct investment removed.

The Canadian Federal Government is considering new policies that affect the treatment of foreign banks in Canada. It may, for example, change current limitations on foreign bank holdings under the Federal Bank Act. This shift will likely be addressed both in bilateral talks and the new GATT Round. The Canadians, in turn, want more freedom to buy in the U.S. banking and insurance industries.

In addition, protection of intellectual property (patents, copyrights and trademarks) against infringement is not as strong in Canada as in the U.S., which has put Canada at a disadvantage in attracting companies to set up research and development facilities. But more importantly, future technological progress in North America is at risk because firms are adverse to taking on costly investment in software and semiconductor development, particularly without adequate patent and copyright protection. Improved patent protection for U.S. pharmaceuticals is a critical concern.

Steel

Steel production in Canada is almost entirely concentrated in Ontario. Canadian producers are currently exempt from U.S. steel quotas under the Voluntary Restraint Agreement (VRA) Program, primarily because the Canadian and U.S. markets are too integrated and such restraints would hurt U.S. producers. Canada made a "gentlemen's agreement" with the U.S., promising not to exploit this open arrangement. However, during the past year, Canada's percentage of U.S. consumption of steel grew from 3 percent to 5 percent, a significant amount in light of the fact that total steel imports account for 23 percent of U.S. consumption. The U.S. wants to stem this recent growth. Canada asserts that the growth is attributed to transshipping and dumping from third countries, and shipments from Canadian companies that are too small to monitor.

With concern growing that the U.S. Congress will place a quota on Canadian steel imports, the Ontario Govenment is pushing the Mulroney Administration to establish a monitoring system under the Canadian Import Tribunal for domestic steel shipments to the U.S. Of particular concern is the flood of specialty steel products to the U.S. market. Industry groups in Canada have urged the federal government to establish an export licensing system to control this flood. Some steel producers are already voluntarily restraining shipments in order to thwart a protectionist backlash.

Energy

Net imports of Canadian electricity have grown from 2.4 million megawatt hours (MHW) in 1970 to 39.5 million MWH in 1984. In regions of the U.S. bordering Canada, the percentage of import use is higher than that for the nation as a whole. New England met 6.4 percent (and New York state, 16.8 percent) of its electricity needs with power from Canada in 1984. Nationwide, Canadian imports accounted for 1.6 percent of U.S. consumption. Current sales agreements between U.S. and Canadian utilities call for 44.7 million MWH to be delivered in 1990.

The price charged for imported power is generally set as a percentage (frequently 80 to 95 percent) of the purchasing utility's cost for alternative domestic sources of electricity. Hydroelectric facilities provide the cheapest electricity. The U.S. General Accounting Office found that the cost of imports was less than the cost of building new power plants in both New England and the Midwest. In large part, this pricing reflects the fact that Canadian provinces of Quebec and Manitoba have vast hydroelectric facilities and the potential for further development. Although electricity trade with Canada involves both exports and imports, the U.S. imported more than it exported, recording a $1.05 billion deficit in 1984. The controversial issue in energy trade with Canada is subsidies. The Northeast-Midwest Region should not be penalized for importing Canadian electric power provided the production of those energy imports from Canada is not subsidized.

The benefits of U.S. electricity trade with Canada are economic. Canadian power is cheaper than the power that the U.S. utilities can produce. For example, the Western Area Power Administration found that they could buy firm power from Manitoba Hydro cheaper than the costs of constructing a coal-fired plant. By importing cheaper electricity from Canada, utilities contribute to their commercial and industrial customers' ability to compete in national and international markets.

Buy National/Provincial Policies

"Buy Provincial" policies are prevalent throughout Canada. One example is the provincial liquor boards, which impede the sales of U.S. beer, wine, and liquor through discriminatory mark-ups or by simple refusal to carry the U.S. products. (This is discussed in more detail in the agriculture section). Policies commonly used by federal and provincial utilities, telecommunications, and transportation agencies also affect related U.S. equipment.

One idea being discussed by both negotiating teams is to completely remove U.S. and Canadian "Buy National" programs as well as Canadian "Buy Provincial" programs, and replace them with a "Buy North American" policy. This program would apply only to government procurement, and not to the private sector. Canadian negotiators will be under strong pressure, however, to uphold existing federal and provincial policies that protect domestic industries. Provincial governments will be sensitive to any agreement negotiated by Ottawa that undermines their ability to favor local industries, particularly agriculture, where there are numerous differential tax rates and subsidies. In addition, Canada will be concerned with improving its access to U.S. Government procurement. The Canadian Government is expected to request equal rights to procurement at federal and state levels that are currently enjoyed by U.S. companies.

Conclusion

In general, the United States and Canada enjoy a healthy trade relationship. However, the trade policies and arrangements discussed in this report point to areas that need to be addressed to enhance the efficiency of both economies. It is in the best interest of both countries to reach a comprehensive trade agreement in order to improve cooperation and ultimately our competitiveness in world markets.

Canada likely will reap the most benefits from a bilateral agreement because it will increase and secure domestic producers' access to the large U.S. market. This access will allow Canadian producers to specialize within an industry and enjoy economies of scale in production. Liberalized trade with Canada also will benefit U.S. producers by improving their ability to compete with Canadian producers in the northern market. The trade pact also gives the U.S. Government and industry the opportunity to address troublesome bilateral trade issues, particularly in automotives, services, and agriculture. And finally, the pact serves to demonstrate to other trading partners our commitment to freer and fairer trade.

IX. Recommendations

Several of the following recommendations have been cited from various reports produced by industry associations, state and federal offices, and public affairs organizations that have a vested interest in the outcome of the U.S.-Canadian free trade talks. These suggestions should serve as a starting point in thinking of specific changes the Congress may want to seek to improve bilateral trade relations.

General Trade

- Establish an impartial Bilateral Trade Dispute Tribunal to handle trade remedy law and investment disputes. The Tribunal could have power to enforce decisions or serve as an advisory to the Canadian and U.S. government.

- Clarify provisions and applications of U.S. trade remedy laws. Narrow differences between U.S. and Canadian countervailing duty and dumping laws. Refer trade remedy cases to a Bilateral Trade Dispute Tribunal before a final decision of injury or unfair trade practice is made.

- Establish a clear definition of subsidies for both countries as well as a bilateral dispute settlement mechanism to resolve major differences.

- Establish a U.S.-Canadian Commission on Trade to monitor trade performance, to review the general competitive health industries, and to assess the progress of sector adjustment following implementation of the trade agreement. The Commission could solve the problem of widely disparate U.S. and Canadian trade figures by reconciling the differences between the two countries' statistics and publishing its analysis.

- Establish a phase-in period for new trade arrangements under the bilateral agreement, with an extended phase-in period (for example, 10 years) for industries that are expected to require significant structural adjustment.

- Establish a strong Rule of Origin program to affect all products. Because the U.S. and Canada are not going to be able to harmonize their external tariffs, a rule of origin would ensure that sufficient production takes place in both countries. This provision could require that a certain percentage of the customs value of products be manufactured in Canada or the U.S. in order to receive duty-free treatment under the free trade agreement. A Rule of Origin would thereby ensure that products from third countries undergo considerable processing in either Canada or the U.S. before receiving duty-free treatment.

- Address Canadian customs problems at the border, particularly bureaucratic delays, documentation procedures, burdensome health and sanitary requirements for agriculture products, and long quarantine periods for live animals. These problems all work to slow U.S. export shipments, thereby hampering the ability of U.S. exporters to effectively compete in the Canadian market.

Government Procurement

- Establish a "Buy North American" policy for government procurement at federal, provincial, and state levels. This provision will require a monitoring system to ensure that fair access is given, and that provincial programs and laws that discriminate against U.S. contractors are eliminated.

Automotive Products

- Eliminate the duty remissions program in Canada. The U.S. should not agree to any concessions with Canada in exchange for eliminating this program since it is an illegal export subsidy.

- Eliminate the Canadian multilateral implementation of the Auto Pact. U.S.-based parts suppliers and manufacturers should receive preferential treatment in trade with Canada; the benefits of duty-free trade in automotive products should not be extended to third countries.

- Change the current 60 percent Canadian value-added requirement to a North American value-added requirement. This would allow U.S.-based parts suppliers to sell to Canadian-based manufacturers and meet the majority of the value of Canadian vehicle production.

Agriculture

- Eliminate the discriminatory licensing practices of the Canadian Wheat Board. One possibility is to replace the CWB with a bilateral board to oversee North American exports and imports of grain.

- Eliminate the unfair trade practices in the Canadian wine and malt beverages sector. Particularly egregious policies include discriminatory distribution of wine imports by the provincial liquor control boards, enormous price mark-ups for imported wines, and listing practices that effectively bar U.S. wines from provincial markets.

- Any changes in agriculture policies will directly affect the food processing industries; therefore, policies affecting the two sectors will need to be harmonized under a trade agreement.

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APPENDICES

Attachment A

Canadian Trade with the Northeast-Midwest Region: Ten Leading Export and Import Sectors by State, 1985
(Millions of US Dollars)

New England

Connecticut

Canadian Exports		Canadian Imports
Newsprint Paper	86.8	Aircraft Engines and Parts
Printed Matter	84.7	Aircraft Parts, except Engines
Copper and Alloys	72.4	Electronic Computers
Lumber, softwood	63.7	Equipment and Tools
Aircraft parts, except Engines	38.9	Motor Vehicle Parts, except Engines
Aircraft, engines and parts	38.9	Unshaped Plastics Materials
Telecommunications Equipment	32.0	Precious Metals, Including Alloys
Syn. Rubber and Plastics Materials	26.3	Organic Chemicals
Non-Metallic Minerals	22.8	Bearings
Aircraft Complete with Engines	20.2	Other Chemical Products
Total for Leading 10 Exports	488.7	Total for Leading 10 Imports

New Hampshire

Canadian Exports		Canadian Imports	
78.6	Lumber, softwood	52.0	Electronic Computers	21.1
47.1	Fish, Fillets & Blocks Fresh, Froz.	27.6	Motor Vehicle Parts, except Engines	19.5
32.5	Petroleum and Coal Products	20.2	Lumber	8.2
24.7	Wood Pulp and Similar Pulp	20.1	Crude Wood Materials	7.8
21.9	Newsprint Paper	13.4	Electronic Property Measuring Instru.	7.2
21.7	Telecommunications Equipment	10.2	Telecommunications Equipment	6.1
21.6	Non-metallic Minerals	9.1	Organic Chemicals	5.7
20.4	Fishery Foods and Feeds	7.8	Printing Presses	5.4
17.9	Meat	7.7	Paper and Paperboard	3.0
16.5	Drilling, Excavating, Mining Machinery	7.6	Laboratory Equipment	2.8
303.1	Total for Leading 10 Exports	175.7	Total for Leading 10 Imports	86.9

Maine

Canadian Exports		Canadian Imports
Wood Pulp and Similar Pulp	226.4	Crude Wood Materials
Electricity	157.1	Paper and Paperboard
Petroleum and Coal Products	49.3	Fish and Marine Animals
Fishery Foods and Feeds	41.7	Telecommunication Equipment
Lumber, softwood	38.2	Lumber
Inorganic Chemicals	16.8	Motor Vehicle Parts, except Engines
Non-metallic Minerals	12.0	Electronic Computers
Vegetables & Vegetable Preparations	10.7	Electronic Tubes & Semi-conductors
Newsprint Paper	8.9	Other Elec. Lighting Distrib. Equip.
Fresh and Frozen Fish Fillets	8.6	Wood Fabricated Materials
Total for Leading 10 Exports	569.8	Total for Leading 10 Imports

Rhode Island

Canadian Exports		Canadian Imports	
67.5	Precious Metals, Including Alloys	227.8	Precious Metals, Including Alloys	28.4
53.0	Newsprint Paper	41.6	Metal Fabricated Basic Production	11.1
10.7	Lumber, softwood	15.2	Watches, Clocks, Jewelry, Silverware	9.7
9.7	Copper and alloys	9.9	Electronic Computers	8.8
7.8	Fishery Foods and Feeds	4.9	Basic Glass Products	5.1
4.2	Iron and Steel and Alloys	4.6	Stationer's and Office Supplies	4.0
3.9	Oils, Fats, Waxes, Extracts, Derivates	4.3	Metallic Ores and Scrap Metal	3.6
3.6	Non-metallic Minerals	3.3	Plastic Film and Sheets	3.2
3.2	Metal Fabricated Basic Products	3.0	Games, Toys, and Children's Vehicles	3.1
2.9	Meat	3.0	Rubber Fabricated Materials	2.6
166.4	Total for Leading 10 Exports	317.5	Total for Leading 10 Imports	79.6

Massachusetts

Canadian Exports		Canadian Imports
Fresh and Frozen Fish Fillets	275.0	Electronic Computers
Lumber, softwood	191.9	Aircraft Engines and Parts
Office Machines and Equipment	161.3	Electronic Tubes & Semi-conductors
Fishery Foods and Feeds	154.8	Telecommunications Equipment
Newsprint Paper	151.9	Laboratory Equipment
Motor Vehicle Parts, except engines	138.1	Fish and Marine Animals
Petroleum and Coal Products	96.0	Paper and Paperboard
Electricity	85.5	Printing Machinery and Equipment
Fresh and Frozen Fish	54.7	Plastic Film and Sheet
Telecommunications Equipment	53.2	Medical and Related Equipment
Total for Leading 10 Exports	1,362.4	Total for Leading 10 Imports

Vermont

Canadian Exports		Canadian Imports	
440.8	Trucks, Truck Tractors, and Chassis	128.1	Electronic Tubes & Semi-conductors	68.4
114.5	Passenger Automobiles and Chassis	73.0	Aircraft Engines and Parts	14.1
42.1	Telecommunications and Equipment	54.2	Lumber	8.5
36.2	Electricity	52.0	Aircraft Parts, except Engines	5.2
32.7	Petroleum and Coal Products	37.2	Paper and Paperboard	4.4
29.8	Lumber, softwood	30.1	Crude Non-Metallic Minerals	4.4
27.5	Railway Rolling Stock	19.0	Crude Wood Materials	4.3
22.2	Foods and Materials for Food	16.4	Special Industry Machinery	3.6
21.9	Wood Pulp and Similar Pulp	12.6	Equipment and Tools	3.3
19.6	Toys, Games, and Sporting Equipment	12.5	Pigments, Lakes, and Toners	3.2
787.5	Total for Leading 10 Exports	435.1	Total for Leading 10 Imports	119.3

Source: The Ontario Ministry of Industry, Trade, and Technology

Mid-Atlantic

Delaware

Canadian Exports		Canadian Imports	
Motor Vehicle Parts, except Engines	196.5	Unshaped Plastics Materials	58.8
Motor Vehicle Engines and Parts	64.9	Unexposed Photo Film, Plates, & Paper	27.5
Precious Metals, Including Alloys	30.5	Organic Chemicals	27.4
Lumber, softwood	20.8	Plastic Film and Sheet	24.7
Aircraft complete with Engines	10.8	Man-made Fibers	23.2
Crude Petroleum	7.2	Chemical Products	21.4
Organic Chemicals	6.6	Inorganic Chemicals	12.3
Wood Pulp and Similar Pulp	4.4	Man-made Fibre, Yarn, and Thread	8.6
Newsprint Paper	3.7	Pigments, Lakes, and Toners	7.4
Fertilizers and Fertilizer Material	3.7	Synthetic and Reclaimed Rubber	7.0
Total for Leading 10 Exports	349.2	Total for Leading 10 Imports	218.3

New York

Canadian Exports		Canadian Imports	
Passenger Automobiles and Chassis	3,127.4	Precious Metals, Including Alloys	641.4
Precious Metals, Including Alloys	819.7	Motor Vehicle Parts, except Engines	621.4
Petroleum and Coal Products	499.9	Electronic Tubes & Semi-conductors	425.9
Trucks, Truck Tractors, and Chassis	499.1	Electronic Computers	208.5
Electricity	458.5	Metallic Ores and Scrap Metal	197.3
Telecommunications Equipment	444.6	Motor Vehicle Engines	149.9
Newsprint Paper	441.2	Photographic Goods	145.7
Natural Gas	437.7	Aluminum, Including Alloys	136.2
Crude Petroleum	372.0	Books and Pamphlets	102.7
Motor Vehicle Parts, except Engines	366.1	Telecommunications Equipment	90.6
Total for Leading 10 Exports	7,466.3	Total for Leading 10 Imports	2,719.6

Maryland

Canadian Exports		Canadian Imports	
Lumber, softwood	82.8	Motor Vehicle Parts, except Engines	43.5
Newsprint Paper	51.7	Motor Vehicle Engines	33.1
Motor Vehicle Parts, except Engines	50.2	Chemical Products	19.5
Iron Ores and Concentrates	40.0	Equipment and Tools	16.9
Aircraft complete with Engines	22.6	Hand Tools and Cutlery	14.4
Steel Bars and Rods	21.0	Electronic Computers	13.0
Other Equipment and Tools	20.8	Excavating Machinery	7.6
Office Machines and Equipment	17.8	Inorganic Chemicals	7.3
Crude Non-Metallic Minerals	15.1	Aircraft complete with Engines	5.7
Iron and Steel and Alloys	11.2	Telecommunications Equipment	5.7
Total for Leading 10 Exports	333.1	Total for Leading 10 Imports	166.7

Pennsylvania

Canadian Exports		Canadian Imports	
Newsprint Paper	253.6	Motor Vehicle Parts, except Engines	179.4
Office Machines and Equipment	170.1	Passenger Autos and Chassis	86.9
Motor Vehicle Parts, except Engines	158.4	Electronic Computers	84.8
Lumber, softwood	146.5	Trucks, Truck Tractors, and Chassis	59.8
Aluminum, Including Alloys	110.5	Unshaped Plastics Materials	57.1
Wood Pulp and Similar Pulp	79.6	Organic Chemicals	53.1
Iron Ores and Concentrates	63.5	Steel Strip, Plate, and Sheet	47.9
Meat	54.0	Chemical Products	47.4
Nickel and Alloys	45.1	Inedible Fabricated Materials	38.0
Petroleum and Coal Products	37.9	Metallic Ores and Scrap Metal	38.0
Total for Leading 10 Exports	1,129.1	Total for Leading 10 Imports	692.3

New Jersey

Canadian Exports		Canadian Imports	
Newsprint Paper	190.7	Chemical Products	61.7
Lumber, softwood	109.3	Books and Pamphlets	51.1
Petroleum and Coal Products	59.6	Organic Chemicals	48.9
Motor Vehicle Parts, except Engines	55.2	Electronic Computers	47.2
Equipment and Tools	49.5	Motor Vehicle Parts, except Engines	44.1
Precious Metals, Including Alloys	47.8	Medical Supplies	41.0
Office Machines and Equipment	43.3	Unshaped Plastics Materials	40.6
Aluminum, Including Alloys	42.4	Paper and Paperboard	31.0
Organic Chemicals	38.1	Precious Metals, Including Alloys	30.9
Metal Fabricated Basic Products	37.0	Telecommunications Equipment	30.1
Total for Leading 10 Exports	672.9	Total for Leading 10 Imports	426.7

Source: The Ontario Ministry of Industry, Trade, and Technology

Midwest

Illinois

Canadian Exports		Canadian Imports	
Crude Petroleum	1,153.8	Motor Vehicle Parts, except Engines	309.6
Trucks, Truck Tractors, and Chassis	360.7	Front End Loaders	191.9
Newsprint Paper	273.8	Tractor Engines and Parts	97.2
Motor Vehicle Parts, except Engines	172.3	Newspapers, Magazines, & Periodicals	78.9
Organic Chemicals	143.0	Telecommunications Equipment	75.8
Petroleum and Coal Products	111.8	Combine Reaper-Threshers	74.5
Lumber, softwood	100.2	Railway Rolling Stock	60.6
Office Machines and Equipment	67.0	Electronic Computers	60.3
Telecommunications Equipment	65.1	Power Shovels	57.0
Aluminum, Including Alloys	63.5	Chemical Products	57.0
Total for Leading 10 Exports	2,511.3	Total for Leading 10 Imports	982.8

Minnesota

Canadian Exports		Canadian Imports	
Crude Petroleum	1,303.2	Electronic Computers	164.2
Natural Gas	332.9	Iron Ores and Concentrates	38.7
Lumber, softwood	106.6	Motor Vehicle Parts, except Engines	30.0
Fertilizers and Materials	105.6	Oil Seed Cake and Meal	28.3
Petroleum and Coal Products	94.9	Equipment and Tools	23.7
Wood Pulp and Similar Pulp	89.2	Telecommunications Equipment	19.0
Newsprint Paper	83.7	Measuring Instruments	15.7
Electricity	72.7	Motor Vehicles	15.3
Motor Vehicle Parts, except Engines	61.4	Sugar Preparations & Confectionary	13.3
Office Machines and Equipment	38.9	Medical Supplies	12.2
Total for Leading 10 Exports	2,289.1	Total for Leading Imports	360.3

Indiana

Canadian Exports		Canadian Imports	
Crude Petroleum	506.1	Motor Vehicle Parts, except Engines	1,022.2
Motor Vehicle Parts, except Engines	105.7	Motor Vehicle Engines	181.5
Newsprint Paper	81.6	Aux. Elec. Equipment for Engines	124.7
Lumber, softwood	65.0	Televisions, Radios, & Phonographs	81.0
Petroleum and Coal Products	55.8	Equipment and Tools	49.1
Zinc, Including Alloys	50.5	Aircraft Engines and Parts	40.8
Iron Ores and Concentrates	32.5	Motor Vehicle Engine Parts	38.3
Aluminum, Including Alloys	29.8	Telecommunications Equipment	34.5
Office Machines and Equipment	24.6	Electric Lighting Fixtures and Lamps	33.7
Telecommunications Equipment	22.7	Unshaped Plastic Materials	22.4
Total for Leading 10 Exports	974.2	Total for Leading 10 Imports	1,628.3

Ohio

Canadian Exports		Canadian Imports	
Motor Vehicle Parts, except Engines	848.1	Motor Vehicle Parts, except Engines	1,441.3
Petroleum and Coal Products	260.6	Coal	522.0
Newsprint Paper	203.9	Motor Vehicle Engines	258.8
Lumber, softwood	124.8	Trucks, Truck Tractors, and Chassis	174.7
Inorganic Chemicals	103.4	Motor Vehicle Engine Parts	77.2
Motor Vehicle Engines and Parts	93.9	Transportation Equipment	72.9
Aluminum, Including Alloys	87.8	Equipment and Tools	63.7
Wood Pulp and Similar Pulp	76.2	Electronic Computers	54.9
Iron Ores and Concentrates	66.4	Chemical Products	52.5
Office Machines and Equipment	59.5	Iron Ores and Concentrates	51.9
Total for Leading 10 Exports	1,924.4	Total for Leading Imports	2,769.9

Iowa

Canadian Exports		Canadian Imports	
Natural Gas	69.8	New Wheel Tractors	84.4
Newsprint Paper	49.2	Equipment and Tools	36.8
Live Animals	20.0	Motor Vehicle Parts, except Engines	36.3
Fertilizers and Materials	19.6	Excavating Machinery	20.5
Transportation Equipment	16.3	Soil Prep., Seeding & Fert. Machinery	16.8
Aluminum, Including Alloys	16.3	Wood Fabricated Materials	14.2
Telecommunications Equipment	10.2	Front End Loaders	13.9
Lumber, softwood	9.7	Haying & Harvesting Machinery	12.2
Motor Vehicle Parts, except Engines	8.4	Transportation Equipment	11.1
Metallic Ores and Scrap Metal	7.5	Telecommunications Equipment	10.5
Total for Leading 10 Exports	227.0	Total for Leading 10 Imports	256.6

Wisconsin

Canadian Exports		Canadian Imports	
Wood Pulp and Similar Pulp	296.0	Motor Vehicle Parts, except Engines	187.4
Motor Vehicle Parts, except Engines	264.6	New Wheel Tractors	114.8
Passenger Automobiles and Chassis	103.2	Equipment and Tools	80.6
Newsprint Paper	87.1	Aux. Elec. Equipment for Engines	42.5
Crude Petroleum	53.8	Pulp and Paper Industries Machinery	36.5
Lumber, softwood	41.6	Paper and Paperboard	34.7
Petroleum and Coal Products	25.0	Marine Engines and Parts	31.4
Meat	18.2	Tractor Engines and Parts	29.9
Paper for Printing	17.1	Excavating Machinery	28.2
Synthetic Rubber and Plastics Materials	16.2	Iron Ores and Concentrates	26.6
Total for Leading 10 Exports	922.9	Total for Leading Imports	614.6

Michigan

Canadian Exports		Canadian Imports	
Passenger Automobiles and Chassis	8,288.7	Motor Vehicle Parts, except Engines	5,137.4
Trucks, Truck Tractors, and Chassis	2,949.8	Motor Vehicle Engines	466.9
Motor Vehicle Parts, except Engines	2,282.8	Motor Vehicle Engines Parts	372.6
Motor Vehicle Engines and Parts	1,205.3	Crude Petroleum	196.7
Natural Gas	330.8	Steel Strip, Plate, and Sheet	135.3
Petroleum and Coal Products	321.2	Aux. Elec. Equipment for Engines	124.8
Crude Petroleum	275.2	Petroleum and Coal Products	95.5
Steel Sheet, Plate, and Strip	260.8	Iron Ores and Concentrates	85.0
Newsprint Paper	176.2	Metalworking Machine Tools	78.8
Lumber, softwood	136.2	Bolts, Nuts, and Screws	76.5
Total for Leading 10 Exports	16,227.0	Total for Leading Imports	6,769.4

Source: The Ontario Ministry of Industry, Trade, and Technology

Attachment B

U.S. Canadian Auto Pact and Duty Remissions Program

Twenty-five years ago, Canada faced a growing automotive trade deficit, spurred in part by the increase in U.S. imports to meet the growing demand for passenger cars in Canada. The Canadian Government responded with a Duty Remissions Program, which provided a rebate on duties of certain automotive products for those manufacturers that agreed to increase the Canadian content of exported auto parts. The U.S. industry attacked the program as an export subsidy, and filed a petition to impose a countervailing duty. The tension was resolved in January of 1965, when the U.S. and Canada signed the Auto Pact providing for duty-free trade in automotive products provided certain requirements were met. As a result, Canada agreed to drop the Duty Remissions Program.

Canadian Implementation

Duty-free Treatment Tied to Canadian Production

The Government of Canada extends duty-free treatment to motor vehicles and original equipment parts only when they are imported by a Canadian-based manufacturer meeting certain requirements. A manufacturer must maintain a "production-to-sales" ratio of 75 percent; that is, the manufacturer must produce at least three motor vehicles in Canada for every four vehicles sold in Canada.

In addition, each Canadian-based manufacturer entered into separate commitments to maintain "Canadian value added" (CVA) in each vehicle produced in Canada. These commitments, contained in "Letters of Undertaking," require each manufacturer to increase the Canadian value added each year by 60 percent of the growth in sales of motor vehicles in Canada. This requirement effectively maintains the CVA at 60 percent of Canadian production. A Canadian-based manufacturer that meets both requirements (production-to-sales ratio and Canadian value added) is considered a "qualified manufacturer."

Multilateral Implementation

Once a Canadian-based manufacturer is determined to be "qualified," that manufacturer is allowed to import finished motor vehicles and parts duty-free from anywhere in the world.

U.S. Implementation

The U.S. extends duty-free treatment to motor vehicles and parts imported from Canada where at least 50 percent of the content is U.S. and/or Canadian. The U.S., unlike Canada, implemented the Auto Pact on a bilateral basis, limiting duty-free treatment only to Canadian automotive products.

Duty Remissions Program

The Canadian Government has resumed its use of a Duty Remissions Program in order to encourage exports of Canadian parts, and attract increased investment in manufacturing facilities, primarily by Japan and Korea.

The Duty Remissions Program allows a manufacturer that purchases Canadian parts for export a reduced duty on its imports of finished vehicles. The manufacturer pays the duty on the value of its finished vehicles imported into Canada minus all or a portion of the CVA contained in the parts purchased for export. The amount of CVA subtracted, and thus the amount of reduction in duty, depends on whether the manufacturer has made an investment in a manufacturing facility in Canada.